

Issue: Income Earned in Illinois/Individual Residency

1. The Department's prima facie case, inclusive of all jurisdictional elements, is established by the Notice of Deficiency, which indicates that for the taxable year, taxpayer was an Illinois resident, had

net income in the amount of \$5,840 and failed to file a state income tax return. (Dept. Ex. No. 1)

2. Since 1981, taxpayer has been totally disabled and has been receiving long term disability benefits through her employer, XXXXX, since 1982. (Testimony of XXXXX)

3. For the tax year at issue, taxpayer's principal source of income for the taxable year consisted of the aforementioned long term disability benefits. (Testimony of XXXXX; Dept. Ex. No. 1)

4. Although federal income taxes were withheld, no state taxes were ever withheld from these benefits by the administrator of the plan. (Testimony of XXXXX; Taxpayer Ex. No. 2, 3)

5. Upon becoming disabled, taxpayer had several conferences with people in the Human Resources Department of her employer where the terms of the policy were explained to her. (Testimony of XXXXX)

6. Taxpayer was never advised that such benefits were taxable in the state of Illinois and taxpayer did not believe that they were taxable. (Testimony of XXXXX)

7. Taxpayer has severe back problems and has been on medication which affects her memory and her ability to function. (Testimony of XXXXX)

8. After receiving the Notice of Deficiency, XXXXX, the daughter of taxpayer, spoke with an unidentified person from the office of the plan administrator, who advised XXXXX that the plan in question was qualified under Internal Revenue Code Sections 402 through 408. (Testimony of XXXXX)

9. The record was left open until May 20, 1995 in order for taxpayer to supply written verification that the plan under which she was receiving benefits was qualified under IRC Sections 402 through 408 but no such verification was ever provided.

CONCLUSIONS OF LAW: Section 502(a) of the Illinois Income Tax Act (35 ILCS 5/502(a)) requires the filing of income tax returns by Illinois

residents.

Section 201(A) of the Act (35 ILCS 5/201(a)) imposes a tax measured by net income on the privilege of earning or receiving income in or as a resident of this State.

An individual's base income includes all items included in the individual's federal adjusted gross income unless a specific subtraction modification is provided by statute. 35 ILCS 5/203(a).

35 ILCS 5/203(a)(2)(F) provides a deduction (a subtraction modification) for an amount equal to all amounts included in adjusted gross income pursuant to the provisions of Sections 402(a), 402(c), 403(a), 403(b), 406(a), 407(a) and 408 of the Internal Revenue Code

When a taxpayer claims an exemption from a particular tax, or where he or she seeks to take advantage of deductions or credits allowed by statute, the burden of proof is on the taxpayer, as deductions and exemptions are privileges created by statute as a matter of legislative grace. *Bodine Electric Co. v. Allphin* (1980), 81 Ill. 2d 502, 410 N.E.2d 828; *Balla v. Department of Revenue*, 96 Ill.App.3d 293 (1st Dist, 1981) Here, taxpayer was unable to provide satisfactory proof that the disability benefits she was receiving were from a plan which was qualified under Sections 402 through 408 of the Internal Revenue Code so as to be exempt from Illinois income taxation.

The Notice proposed penalties pursuant to 35 ILCS 5/1001, 5/1002(a), and 1005 for failure to timely file a return and pay taxes and for negligence. Sections 1001 and 1005 provide for abatement of penalties upon a showing of reasonable cause. Here, I find that reasonable cause existed. Taxpayer has been severely disabled and, in addition to her disabling back problems, she has been on medication which affects her ability to function. She was never advised that state taxes were due, and such taxes were never withheld from her benefit payments as were federal taxes. She reasonably

assumed that because there was no withholding, the payments were exempt from state taxes. Although unable to provide documentary proof that the plan was federally tax-qualified, at least one person from the company advised taxpayer's daughter that this in fact was the case. The penalties proposed under 35 ILCS 5/1001 and 1005 should be abated, as should the penalties pursuant to 35 ILCS 5/1002(a), as there was neither negligence nor intentional disregard of the law on the part of taxpayer.

Accordingly, I recommend that the tax deficiency proposed in the Notice of Deficiency be upheld and that the penalties be abated.

Administrative Law Judge